

**TENNESSEE DEPARTMENT OF REVENUE
REVENUE RULING #94-29**

WARNING

Revenue rulings are not binding on the Department. This presentation of the ruling in a redacted form is information only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Departmental policy.

SUBJECT

Application of Tennessee gift tax to the lapse of a general power of appointment – either by the nonexercise by the powerholder at the termination of the power or by the powerholder's affirmative action of release.

SCOPE

Revenue rulings are statements regarding the substantive application of law and statements of procedure that affect the rights and duties of taxpayers and other members of the public. Revenue rulings are advisory in nature and are not binding on the Department.

FACTS

A donor of a trust transfers assets to an irrevocable trust. Under the terms of the trust, a beneficiary of the trust, who is not the donor, has a general power of appointment in the form of a right of withdrawal exercisable for a period of sixty (60) days over the transfer to the trust. If the beneficiary (powerholder) fails to exercise or releases the power of appointment, the property continues to be held in trust for a class of beneficiaries.

ISSUE

Does the lapse (either by nonexercise or by release) of a general power of appointment granted to a beneficiary under a trust instrument (which beneficiary is not the donor of the trust) constitute a taxable transfer by the powerholder under the Tennessee gift tax law?

RULING

No.

ANALYSIS

There appears to be no Tennessee case law specifically dealing with this issue. Similarly, there have been no Tennessee Attorney General Opinions nor any Tennessee Department of Revenue Staff Attorney Opinions issued which address this question.

Tennessee Code Annotated § 67-8-101 is the provision of Tennessee law which imposes the gift tax for transfers by gift. Generally, the law imposes a tax “upon the transfer by gift” during any calendar year by any person of real property, tangible personal property and intangible personal property as further described in T.C.A. § 67-8-101(a).

The statute makes no specific reference to powers of appointment, to the exercise of such powers or to the lapse of such powers either by their expiration without exercise or by the powerholder’s affirmative release of the power. Instead, the statute is structured in a manner so as to more narrowly describe property transfers or dispositions and then indicate, variously, that they shall be treated or considered (or not treated or not considered) as transfers by gift for purposes of the gift tax. (See T.C.A. § 67-8-101(b) - (h).)

Only one of the narrowly-defined property transfers mentioned in the statute appears to relate to the fact situation presented by a power of appointment lapse by nonexercise or by release. The potentially applicable portion of the statute (T.C.A. § 67-8-101(c)) provides in part as follows:

. . . The relinquishment or termination (other than by the donor’s death) of *any power* to revest in the donor the property theretofore transferred by the donor *shall be considered to be a transfer* by the donor by gift of the property subject to such power *and shall be taxable hereunder* . . .
(Emphasis added.) T.C.A. § 67-8-101(c).

One might conclude that the legislature’s use of the phrase “any power” means that it intended to tax the lapse of a “power of appointment” by nonexercise or by release.

However, that interpretation is contradicted by the legislature’s further description of the relinquished power which is subject to tax to be “any power *to revest in the donor* the property theretofore *transferred by the donor*. . .” (Emphasis added.) *Id.* Thus, the language of the statute seems to presuppose a property transfer of some sort by a *donor* (not a holder of any power, such as a power of appointment), which transfer is “incomplete” for Tennessee gift tax purposes and which later becomes complete when the donor gives up his right to control the previously transferred property’s use and disposition. At the time the *donor* relinquishes his right to revest in himself the property (which he has “incompletely” transferred to another), the donor’s transfer becomes “complete” for tax purposes and therefore subject to the Tennessee gift tax.

The typical situation which the legislature addressed by enacting the second sentence of T.C.A. § 67-8-101(c) relative to relinquishment or terminations of powers was the “incomplete” transfer of property by a donor to a revocable trust. The donor maintains a right to revoke the transfer to the trust and thus the transfer is not subject to the

Tennessee gift tax until the trust becomes irrevocable or other circumstances arise whereby the donor no longer has any power to revest the property in himself.¹ (Should a revocable trust pay out any income to any beneficiary other than the settlor (donor), subsection (c) expressly provides that the income shall be considered to be a transfer by the donor of such income by gift and shall be taxable under the Tennessee gift tax laws.)

Therefore, T.C.A. § 67-8-101(c) does not operate to specifically impose a gift tax on a powerholder's failure to exercise, or his affirmative release of, a power of appointment over specified property.

Absent any clear guidance from either the Tennessee courts or the language of the Tennessee gift tax law itself, review of the federal gift tax law becomes necessary, since the State Gift Tax Act was, in important respects, modeled after the federal gift tax statute. 23 Tenn. Juris., *Taxation*, § 63. Similarly, an analysis of the Tennessee inheritance tax laws is appropriate considering the long-standing judicial recognition that the Tennessee gift tax law and the Tennessee inheritance tax law must be construed *in pari materia*. *Id.*

Internal Revenue Code Section 2514(b) generally imposes a gift tax on the exercise or release of a general power of appointment created after October 21, 1942. I.R.C. § 2514(e) indicates that a lapse of a power of appointment created after October 21, 1942 shall be considered a release of such power, and would thus be generally taxable under federal law.²

Given the clear provision of the *federal* gift tax law on the lapse of powers of appointment, one might conclude that the Tennessee gift tax law should follow this pattern, in view of judicial authority for the proposition that the Tennessee Gift Tax Act was modeled after the Federal Gift Tax Act. *See Third National Bank in Nashville v. King*, 387 S.W.2d 800 (Tenn. 1965). However, the Tennessee Gift Tax Act (1939 Tenn. Pub. Acts, Chapter 137) was first enacted in 1939, *before* the October 21, 1942 effective date of the revisions to the Federal gift tax law which generally subjected the exercise or release of powers of appointment to tax. This would rule out the possibility that the Tennessee gift tax law on the lapse (by nonexercise or release) of powers of appointment was patterned after the federal gift tax law on the subject.

Looking on to the Tennessee inheritance tax laws, it can be seen that, prior to 1978, the inheritance tax laws subjected "transfers under powers of appointment" to tax in like manner and to the same extent as if the property of the testator or donor was transferred.

¹ It must be noted also that donors of property to trusts (whether the trust established be revocable or irrevocable) do not typically give *themselves* a power of appointment over trust assets since that action may operate to frustrate some of the purposes in establishing the trust in the first place.

² Subsection (e) of I.R.C. § 2514 also provides a limited exception to the general rule for certain lapses which do not, in a calendar year, exceed the greater of \$5,000 or 5% of the aggregate value of the assets from which the lapsed power could be exercised.

T.C.A. § 30-1602(h), effective through October 30, 1978.³ While the inheritance tax statute failed to indicate specifically whether “transfers under powers of appointment” included both the exercise and the lapse by exercise or by release of powers of appointment, the Tennessee Supreme Court issued a clear opinion on this point in *American Nat. Bank & T. Co. of Chattanooga v. Benson*, 474 S.W.2d 427 (Tenn. 1971), by stating the following:

Section 30-1602(h) provides that “transfers under powers of appointment shall be taxable in like manner and to the same extent as if property of the testator or donor was transferred.” It is impossible to read this statute, bearing in mind the result sought, without appreciating that the tax is laid upon the exercise of the power of appointment . . .

The tax is laid on “*transfers* under powers of appointment” which, in context, purpose and intent, means the *exercise* of the power of appointment; and upon the privilege of receiving, pursuant to the exercise of the power. This interpretation of the statute is consistent with its provision that the tax is levied, not with respect to the act of the donor of the power, but, with respect to an act by the donee, a “transfer”, which can only be accomplished by the exercise of the power of appointment. (Emphasis by the court.) *Id.* at 429.

Thus, until the Tennessee legislature amended T.C.A. § 30-1602(h), only the *exercise* of powers of appointment by decedents resulted in Tennessee inheritance tax to the decedent’s estate.

However, in 1978 the Tennessee legislature amended various provisions of both the Tennessee gift and inheritance tax laws. 1978 Tenn. Pub. Acts, Chap. 731. Section 2 of that law provided as follows:

Tennessee Code Annotated, § 30-1602,⁴ is amended further by deleting subsection (h) therefrom and substituting therefor the following:

(h) The value of all property with respect to which the decedent had a power of appointment shall be taxable to the same extent that such property would be taxable for federal estate tax purposes under § 2041 of the Internal Revenue Code. The value of any property with respect to which the decedent had a power of appointment which would not be taxable under § 2041 of the Internal Revenue Code shall

³ The current codification of the provision of Tennessee inheritance tax law relative to powers of appointment is T.C.A. § 67-8-304(8).

⁴ As was noted previously in Footnote 3, the current codification of the provision of Tennessee inheritance tax law relative to powers of appointment is T.C.A. § 67-8-304(8).

not be taxable under this chapter, whether or not such power is exercised.

Thus, the Tennessee inheritance tax law, as amended in 1978 (and as currently in effect today), basically followed the applicable federal estate tax law, Internal Revenue Code Section 2041. The latter provision generally imposed a federal estate tax on the exercise *or* release (including lapses) of a general power of appointment subject to certain limited exceptions specified in the statute.⁵

It is clear from the above analysis that the Tennessee legislature intended to impose the Tennessee *inheritance* tax upon the exercise *or* the release of a general power of appointment as provided in the 1978 amendment to the Tennessee law. However, the Tennessee legislature which adopted this particular amendment to the Tennessee inheritance tax law, making specific reference to a parallel federal estate taxing statute which taxed certain exercises or releases of powers of appointment (I.R.C. § 2041), failed to make a similar parallel reference to the federal *gift* tax law which did essentially the same thing (i.e. taxed certain exercises *or* releases of power of appointment. I.R.C. § 2514.)

Therefore, to summarize, the language of the Tennessee gift tax statute itself does *not* clearly provide that the lapse of a general power of appointment (either by the nonexercise by the powerholder at the termination of the power or by the powerholder's affirmative action of release) shall constitute a taxable transfer by the powerholder. The Tennessee legislature could have used statutory language which would specifically subject lapses of powers of appointment to the gift tax; or it could have merely made them taxable to the same extent that they were taxable under the parallel federal gift tax law, I.R.C. § 2514. The legislature in fact did neither. Instead, it failed to make any change to the Tennessee gift tax law relative to powers of appointment in 1978 when it changed the gift tax law in other respects and specifically changed the Tennessee inheritance tax laws to make transfers pursuant to such powers taxable to the same extent that they would be taxable pursuant to I.R.C. § 2041, the federal estate tax law. (*See* 1978 Tenn. Pub. Acts, Chap. 731.)

Based on the above analysis, the opinion of this office is that the lapse (either by nonexercise or by release) of a general power of appointment granted to a beneficiary under a trust instrument (which beneficiary is not the donor of the trust) does not constitute a taxable transfer under the Tennessee gift tax law.⁶

⁵ Subsection (b)(2) of I.R.C. § 2041 provides an exception to the general rule for certain lapses which do not, in a calendar year, exceed the greater of \$5,000 or 5% of the aggregate value of the assets from which the lapsed powers could have been satisfied.

⁶ It must be noted that the *exercise* of a general power of appointment under the circumstances otherwise described in the request for a ruling *would* constitute a taxable transfer under the Tennessee gift tax law since it can be considered a "transfer by gift" by virtue of the property ownership being transferred from the trustee to the beneficiary or beneficiaries who are designated in the exercise of the power. (*See* T.C.A. § 67-8-101(a).)

Thomas R. Bain, Assistant General Counsel

APPROVED: Joe Huddleston, Commissioner

DATE: 12-28-94